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### Reframing and Reforming the Securities and Exchange Commission: Lessons from Literature on Change Leadership

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REFRAMING AND REFORMING THE SECURITIES AND EXCHANGE  
COMMISSION: LESSONS FROM LITERATURE  
ON CHANGE LEADERSHIP

JOAN MACLEOD HEMINWAY\*

IT is a time of change at the U.S. Securities and Exchange Commission (SEC). Faith in the SEC's power to regulate has been low.<sup>1</sup> In the past two years, federal regulators, legal scholars, and other expert commentators have proposed various substantive restructurings of and improvements to the SEC. Serious proposals have ranged from combining the authority of the SEC and the Commodities Futures Trading Commission to expanding or revamping SEC enforcement authority, policies, or procedures.<sup>2</sup> Notwithstanding some commentary to the contrary,<sup>3</sup> change at the SEC has begun and is likely to continue.

Whether certain kinds of change (actual and proposed) are needed, whether SEC officials and other governmental leaders are ready for meaningful change, and whether actual or proposed change efforts will meet desired objectives are important unanswered (and perhaps unanswerable) questions. Even though the SEC has successfully renewed itself in the

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1. See John C. Coffee, Jr. & Hillary A. Sale, *Redesigning The SEC: Does the Treasury Have a Better Idea?*, 95 VA. L. REV. 707, 713 (2009) ("If the rest of the world once looked to the SEC for leadership on issues of securities regulation, the SEC's presumed leadership is very much in question today.").

2. See, e.g., *Financial Regulatory Reform: The SEC Enforcement Perspective*, E-ALERT (Covington & Burling LLP, Wash., D.C.), June 19, 2009, <http://www.cov.com/files/Publication/b645f64c-b4b3-4b20-94d8-128600de9a3d/Presentation/PublicationAttachment/b3c4184e-949b-4bd4-b395-12cef3b1e84c/Financial%20Regulatory%20Reform%20-%20The%20SEC%20Enforcement%20Perspective.pdf>; Ronald D. Orol, *SEC Chief: It Is Logical to Combine the SEC and CFTC*, MARKETWATCH, June 2, 2009, <http://www.marketwatch.com/story/sec-chief-its-logical-to-combine-sec-and-cftc>; Edgar Ortega & Alison Vekshin, *U.S. Should Still Pursue SEC-CFTC Combination*, NYSE CEO SAYS, BLOOMBERG.COM, June 11, 2009, <http://www.bloomberg.com/apps/news?pid=20601087&sid=aVJHnsABbsaA>; Posting of Thomas O. Gorman to SEC Actions, <http://www.secactions.com/?p=871> (Mar. 2, 2009, 03:34 EST).

3. See, e.g., David Weidner, *Dream of SEC Overhaul Fades Along with Crisis*, WALL ST. J., May 7, 2009, available at <http://online.wsj.com/article/SB124163629277392725.htmh>.

past,<sup>4</sup> we have reason to fear unpreparedness and failure in the current environment. The Sarbanes-Oxley Act—our most recent significant reform measure in the realm of securities regulation—was unsophisticated, piecemeal, reactive, crisis-based, limited-impact, politically motivated legislation.<sup>5</sup> The included reforms may have fixed certain discrete problems identified in the corporate fiascos that consumed the first few years of the new millennium, but the changes made did not protect investors and market integrity in a sustained or coherent fashion.<sup>6</sup> In fact, as many have observed, the regulatory changes included in and adopted by the SEC under Sarbanes-Oxley arose less from prudent, thoughtful management and leadership than from a panicked desire to quickly offset negative public reaction to a perceived market crisis.<sup>7</sup> Moreover, “[b]usiness experi-

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4. See JOEL SELIGMAN, *THE TRANSFORMATION OF WALL STREET* 290-348, 688-714 (3d ed. 2003) (describing reforms in market structure during the SEC Chairmanships of William Cary and Arthur Levitt).

5. See *Will it Fly?*, *ECONOMIST*, Apr. 5, 2008 (noting consonant comments of Professors Hal Scott and Frank Partnoy).

6. See, e.g., Marianne M. Jennings, *A Primer on Enron: Lessons From a Perfect Storm of Financial Reporting, Corporate Governance and Ethical Culture Failures*, 39 *CAL. W. L. REV.* 163, 242-43 (2003) (“Additional signatures, additional jail sentences, additional oversight Boards, and additional rules for Boards are the types of changes that seem logical, punitive and satisfying for an investor class hungry for the restoration of trust. However, . . . it is not clear that they address the root cause of the problems that gave rise to Enron’s perfect storm, a storm that has now found its way into the bellies of other companies.”); Larry E. Ribstein, *Market vs. Regulatory Responses to Corporate Fraud: A Critique of the Sarbanes-Oxley Act of 2002*, 28 *J. CORP. L.* 1, 2 (2002) (favoring market-based reform over the regulatory changes imposed by Sarbanes-Oxley); Roberta Romano, *The Sarbanes-Oxley Act and the Making of Quack Corporate Governance*, 114 *YALE L.J.* 1521, 1602 (2005) (“In the frantic political environment in which SOX was enacted, legislators adopted proposals of policy entrepreneurs with neither careful consideration nor assimilation of the literature at odds with the policy prescriptions.”).

7. See, e.g., Donald C. Langevoort, *Someplace Between Philosophy and Economics: Legitimacy and Good Corporate Lawyering*, 75 *FORDHAM L. REV.* 1615, 1624 (2006) (“[C]onsider the many prophylactic requirements of the Sarbanes-Oxley Act, which are widely seen as a knee-jerk political reaction disproportionate to the severity of the underlying problems, costing shareholders (the primary intended beneficiaries) far more than any benefits it might generate.”); Jonathan Macey, *Executive Branch Usurpation of Power: Corporations and Capital Markets*, 115 *YALE L.J.* 2416, 2437 (2006) (“Sarbanes-Oxley was passed in a panicked frenzy as Congress and the President attempted to quell the public outrage over Enron and perhaps even to gain some measure of political advantage from the scandals.”); Romano, *supra* note 6, at 1523 (“SOX was enacted in a flurry of congressional activity in the runup to the midterm 2002 congressional elections after the spectacular failures of the once highly regarded firms Enron and WorldCom.”); Cheryl L. Wade, *The Sarbanes-Oxley Act and Ethical Corporate Climates: What the Media Reports; What the General Public Knows*, 2 *BROOK. J. CORP. FIN. & COM. L.* 421, 440 (2008) (“Business leaders complain that SOX was hastily enacted and that its benefits are severely outweighed by its costs . . . .”); Stephen M. Bainbridge, *Sarbanes-Oxley: Legislating in Haste, Repenting in Leisure 2* (UCLA Law & Econ. Research Paper Series, Paper No. 06-14, 2006), available at <http://ssrn.com/abstract=899593> (“Congress was in too much of a hurry for very much in the way of serious cost-benefit analysis. Instead, they threw a bunch of ideas into a single basket and rushed it into law so that angry

ence indicates that about two-thirds of all organizational change efforts fail to meet their goals.”<sup>8</sup> Current proposals for SEC reform constitute or involve organizational change, and there is no reason to believe that organizational change efforts affecting the SEC will be more successful than those undertaken in the non-governmental business world.

In fact, there are strong parallels between independent agencies (of which the SEC is one example)<sup>9</sup> and business corporations.<sup>10</sup> Both are, at their structural core, bureaucracies—organizations with similar management hierarchies built on trust relationships between the beneficiaries of their operations and those who manage and conduct those operations.<sup>11</sup> Both agencies and firms “use authority to organize the decisional environments of their members and to reduce transaction costs,”<sup>12</sup> and both “also face internal transaction costs” arising “from each organization’s need to delegate decision-making within its ranks.”<sup>13</sup> Further, both are boundedly rational in their decision-making.<sup>14</sup>

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investors would blame somebody—anybody—other than Congress for the stock market bubble’s bursting and the corporate governance scandals.”).

8. Lee G. Bolman & Terry E. Deal, *4 Steps to Keeping Change Efforts Heading in the Right Direction*, J. FOR QUALITY & PARTICIPATION, May/June 1999, at 7. Similarly, CEOs surveyed in the 1990s “reported that up to 75% of their organizational change efforts did not yield the promised results.” Myron Rogers & Margaret J. Wheatley, *Bringing Life to Organizational Change*, in FINDING OUR WAY: LEADERSHIP FOR AN UNCERTAIN TIME 83, 83 (Margaret J. Wheatley ed., 2005).

9. See Aulana L. Peters, *Independent Agencies: Government’s Scourge or Salvation?*, 1988 DUKE L.J. 286, 286-88. Independent federal agencies are part of the “Fourth Branch” of the federal government. *See id.* at 286. They are not exclusively controlled by the executive branch or legislative branch, but rather are beholden to some extent to each and also subject to the will of the judicial branch. *See id.* at 286-88. Moreover, they may have executive, legislative, and judicial responsibilities. *See id.* at 286.

10. *See* William G. Childs, *When Criminal and Tort Law Incentives Run into Tight Budgets and Regulatory Discretion*, 34 CAP. U. L. REV. 581, 594 n.53 (2006) (noting that “[a] Westlaw search for ‘like a business’ in the same sentence as ‘government’ or ‘agency’ in the last two years returned 514 documents in the ALLNEWS database.”); Molly Elizabeth Hall, *Pollution Havens? A Look at Environmental Permitting in the United States and Germany*, 7 WIS. ENVTL. L.J. 1, 31 (2000) (“Like American business and commercial institutions, government agencies practice a user-friendly approach toward everyone that calls or comes into the office, be they potential investors, state residents, or members of an environmental group.”).

11. *See generally* Gerald E. Frug, *The Ideology of Bureaucracy in American Law*, 97 HARV. L. REV. 1276 (1983) (describing these parallels and identifying four models, based in legal scholarship, that describe and justify both agency bureaucracies and corporate bureaucracies).

12. Eric T. Laity, *The Corporation as Administrative Agency: Tax Expenditures and Institutional Design*, 28 VA. TAX REV. 411, 448 (2008).

13. *Id.* at 450.

14. *See* Thomas O. McGarity, *The Courts and the Ossification of Rulemaking: A Response to Professor Seidenfeld*, 75 TEX. L. REV. 525, 537-38 (1997) (suggesting that both agencies and corporations engage in “techno-bureaucratic rationality” in their decision-making); *see also* Mark Seidenfeld, *Hard Look Review in a World of Techno-Bureaucratic Decisionmaking: A Reply to Professor McGarity*, 75 TEX. L. REV. 559, 559 (1997).

Of course, there also are notable differences between governmental administrative organizations and private firms. "Firms can better gather information about demand because they are close to customer preferences by financial necessity. If firms in competitive markets fail to satisfy customer preferences, they will go bankrupt. Government agencies, on the other hand, cannot be forced into bankruptcy and dissolved by their creditors."<sup>15</sup> Moreover, constraints on managers may differ in federal agencies and non-governmental corporations.

Managers of government agencies have far less control over their organizations' activities than their counterparts in private firms since the goals of public agencies are often established by entities outside the organization, such as legislative bodies, courts, interest groups and other government agencies. Private corporations may also be influenced by outside entities, but to a lesser degree than public agencies. Furthermore, unlike their counterparts in private businesses, public managers have little flexibility to alter their organizations' production inputs such as wages.<sup>16</sup>

In addition, although both agency decision-makers and corporate decision-makers enjoy judicial deference, the level of deference may differ (with agency decision-making sometimes subject to a "hard look," a greater level of scrutiny than the presumptions of the business judgment rule allow in the review of disinterested board decision-making in the corporate context).<sup>17</sup>

Yet, despite these differences (and because of the bureaucratic and agency-related similarities) between governmental agencies and corporations, business scholarship, especially the growing literature on management and leadership in times of change (referred to in this Article as "change leadership" literature), offers a number of potentially valuable lenses through which we may assess the SEC's readiness for change, identify and address organizational change issues relevant to current (and future) SEC reform proposals, and support the efforts of related change managers. A variety of germane questions may be derived from hypotheses and theories represented in change leadership literature.

- Do the relevant change leaders have the characteristics necessary to exercise effective change leadership? Leaders in times of change

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15. Laity, *supra* note 12, at 449.

16. Joseph W. Belluck, Comment, *Increasing Citizen Participation in U.S. Postal Service Policy Making: A Model Act to Create a Post Office Consumer Action Group*, 42 BUFF. L. REV. 253, 261 (1994).

17. See McGarity, *supra* note 14, at 525-28 (analogizing judicial review of an artificially constructed corporate decision-making process to judicial review of agency decision-making as means of exploring undesirability of "hard look" standard for judicial review of federal agency rulemaking).

may require different attributes and skills than those who manage in less turbulent times.<sup>18</sup>

- Is our national leadership employing processes that are known to be likely to create successful organizational change? Leaders effectuating reform at the SEC do not have to create a method for change leadership out of whole cloth.<sup>19</sup>
- In assessing possible visions, strategies, and solutions, and in establishing processes for making desired changes, are change leaders operating mechanistically or dynamically? Organizations tend to behave organically, and change may be more successful if leaders acknowledge this.<sup>20</sup>
- Are our national leaders and other change agents taking into account varied views of how organizations work (i.e., human resources needs, structural considerations, political conflicts, and the role of symbols) in approaching the process for reforming the SEC? Leaders who fail to engage and consider different perspectives are less likely to meet with success in organizational change efforts.<sup>21</sup>

With the thought that securities regulators and others may learn valuable lessons about the SEC's restructuring and reorganization from experts in change leadership, this Article explores this selected group of questions by setting forth the answers in the form of lessons from the related literature. These lessons may then be viewed through the lens of the current SEC reform environment. The resulting analysis offers certain positive observations but also allows for certain critiques of, questions about, and advice concerning the processes by which change leaders are selected and reform is undertaken. As a result, the Article highlights certain strengths of and exposes possible weaknesses in current and proposed SEC reform efforts.

To accomplish its purposes, the Article begins by summarizing in Part I the key reform proposals emanating from the global financial crisis and reform efforts being undertaken as of the spring of 2010, when work on this Article was completed. While one may question the wisdom of some or all of the proposed reforms to the SEC's structure and operations, this Article does not focus on the merits of the various proposals. Rather, it focuses on the prospects for successful change once reform proposals are adopted and implemented. Accordingly, in Part II, the Article sets forth four change leadership lessons (derived from the relevant literature) that have bearing on the implementation of SEC reforms and evaluates existing SEC leadership and reform efforts in light of the lessons. A brief conclusion follows in Part III.

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18. *See infra* Part II.A.

19. *See infra* Part II.B.

20. *See infra* Part II.C.

21. *See infra* Part II.D.



## I. CURRENT SEC ORGANIZATIONAL REFORM PROPOSALS AND EFFORTS

“Regulatory bodies, like the people who guide them have a marked life cycle. In their youth they are vigorous, aggressive, evangelistic and even intolerant. Later they mellow, and in old age—in a matter of 10 or 15 years—they become, with some exceptions either an arm of the industry they are regulating or senile.”<sup>22</sup>

One does not have to agree that the SEC was over-the-hill as many as sixty years ago in order to acknowledge that public disclosures of significant instances of corporate and individual securities fraud and revelations of other perceived or actual regulatory failures after the turn of the century exposed certain apparent weaknesses in the structure and operation of the SEC as a regulatory organization. The exposure of these apparent weaknesses has fostered the identification and proposal of various structural and operational changes by political figures and academics alike. Some of these proposals already are being implemented. This part identifies and describes key reform proposals and efforts.

A. *Structural Reform Proposals*

Since the March 2008 release by the U.S. Department of the Treasury of its *Blueprint for a Modernized Financial Regulatory Structure*, proposing significant consolidation of financial regulation (the “Treasury Blueprint”),<sup>23</sup> there have been many further suggestions for financial regulatory reform at the federal level. A number of proposals would eliminate or alter the SEC’s role in U.S. financial regulation. Three of these reforms are briefly described below.

1. *Overhaul or Abolish the SEC*

Although no one seems too serious about this option, there have been calls to wholly revamp or dismantle the SEC and create a new agency or spread the SEC’s useful functions among other government agencies.<sup>24</sup> After all, the functions of the SEC under the Securities Act of 1933 originally were vested in the Federal Trade Commission;<sup>25</sup> the SEC was formed

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22. JOHN KENNETH GALBRAITH, *THE GREAT CRASH 1929* 171 (2d ed. 1961).

23. U.S. DEP’T OF THE TREASURY, *BLUEPRINT FOR A MODERNIZED FINANCIAL REGULATORY STRUCTURE* (2008), available at <http://www.ustreas.gov/press/releases/reports/Blueprint.pdf> [hereinafter *TREASURY BLUEPRINT*].

24. See, e.g., CHARLES GASPARINO, *THE SELLOUT* (2009); Robert Schmidt & Jesse Westbrook, *U.S. May Strip SEC of Powers in Regulatory Overhaul*, BLOOMBERG.COM, May 20, 2009, <http://www.bloomberg.com/apps/news?pid=20601087&sid=a18ctNv3FDcw>; Alan Schram, *Abolish the SEC*, THE HUFFINGTON POST, Dec. 22, 2008, [http://www.huffingtonpost.com/alan-schram/abolish-the-sec\\_b\\_152748.html](http://www.huffingtonpost.com/alan-schram/abolish-the-sec_b_152748.html); Paul Tharp & Mark Decambre, *Cox And Levitt Trade Barbs Over Fighting Frauds*, N.Y. POST, Dec. 18, 2008, at 42; Weidner, *supra* note 3; Alexandra Zendrian, *Letters to the SEC*, FORBES, July 15, 2009, <http://www.forbes.com/2009/07/15/securities-exchange-commission-intelligent-investing-regulation.html>.

25. See SELIGMAN, *supra* note 4, at 70-71.

under the Securities Exchange Act of 1934.<sup>26</sup> The plan for reform published by the U.S. Department of the Treasury in June 2009 (the “Obama Reform Plan”) does not endorse the overhaul or abolition of the SEC,<sup>27</sup> and neither the financial regulation reform bill passed by the U.S. House of Representatives in December 2009 (the “House Reform Bill”) nor the Senate financial reform bill passed in May 2010 (the “Senate Reform Bill”) includes a provision to that effect.<sup>28</sup>

2. *Manage the SEC through the Federal Reserve or the Department of the Treasury*

As the full extent of the financial crisis unfolded in 2008, public reports suggested the SEC might remain extant but be monitored or managed in whole or in part by another, ostensibly more responsible, agency.<sup>29</sup> The other agencies mentioned include the Federal Reserve and the Department of the Treasury. To some, this approach seems absurd because all three regulators can be held responsible for failing to recognize and capitalize on opportunities to spot and stem the tide of various elements of the recent financial crisis.<sup>30</sup> Yet, the idea is borne of a regulatory overlap—here, the overlapping regulation of financial services issuers—that begs for rationalization.<sup>31</sup> Still, there are many things the SEC does, including principally disclosure regulation and enforcement, that are not within the noted expertise of either the Federal Reserve or the Department of the Treasury.<sup>32</sup> It does not make sense to have either of these non-expert regulatory bodies govern the whole of the SEC. None of

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26. 15 U.S.C. § 78(d) (2006).

27. See U.S. DEP’T OF THE TREASURY, FINANCIAL REGULATORY REFORM, A NEW FOUNDATION: REBUILDING FINANCIAL SUPERVISION AND REGULATION 4 (2009) [hereinafter OBAMA REFORM PLAN], available at [http://www.financialstability.gov/docs/regs/FinalReport\\_web.pdf](http://www.financialstability.gov/docs/regs/FinalReport_web.pdf) (“The Securities and Exchange Commission . . . would maintain . . . current responsibilities and authorities . . .”); see also Sara Hansard, *SEC Doesn’t Need a Defibrillator After All; Administration Would Give It More Clout, Boost Funding by 7%*, INVESTMENT NEWS, June 29, 2009, at 3.

28. See Wall Street Reform and Consumer Protection Act of 2009, H.R. 4173, 111th Cong. (2d Sess. 2010), available at [http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=111\\_cong\\_bills&docid=f:h4173eh.txt.pdf](http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=111_cong_bills&docid=f:h4173eh.txt.pdf); see also Restoring American Financial Stability Act of 2010, S. 3217, 111th Cong. (2d Sess. 2010), available at [http://banking.senate.gov/public/\\_files/HR\\_4173\\_Senate\\_passed\\_as\\_amended.pdf](http://banking.senate.gov/public/_files/HR_4173_Senate_passed_as_amended.pdf).

29. See Matt Kelly, *As Priorities Shift, XBRL Loses Spotlight at SEC*, DATA INTERACTIVE, June 1, 2009, <http://hitachidatainteractive.com/2009/06/01/as-priorities-shift-xbrl-loses-spotlight-at-sec/>; Schmidt & Westbrook, *supra* note 24; see also Weidner, *supra* note 3.

30. See Sudeep Reddy, *Congress Weighs Scope of Fed’s Authority*, WALL ST. J., Oct. 28, 2009, available at <http://online.wsj.com/article/SB125677301319414567.html>.

31. In fact, the Treasury Blueprint called for a formalization of existing cooperation practices that operate in areas of regulatory overlap. See TREASURY BLUEPRINT, *supra* note 23, at 85.

32. Cf. Coffee & Sale, *supra* note 1, at 775-79 (summarizing areas of relative expertise of the Federal Reserve and the SEC).

the extant reform proposals—the Obama Reform Plan, the House Reform Bill, and the Senate Reform Bill—provides for SEC supervision by another regulatory body, although the Obama Reform Plan does call for the Federal Reserve Board, rather than the SEC, to engage in consolidated supervision and regulation of certain investment banks and other large, leveraged, interconnected financial firms (known as Tier 1 FHCs).<sup>33</sup>

### 3. *Combine the SEC with the Commodity Futures Trading Commission (CFTC)*

The Treasury Blueprint proposed a consolidation of the SEC and CFTC into a single regulatory agency.<sup>34</sup> The report argued that “[p]roduct and market participant convergence, market linkages, and globalization have rendered regulatory bifurcation of the futures and securities markets untenable, potentially harmful, and inefficient” and called for the SEC to modernize certain aspects of its operations to make a fusion of the SEC and CFTC “more seamless.”<sup>35</sup> Although the Obama Reform Plan does not mandate a combination of the two agencies, it does call for regulatory harmonization as a precursor to possible merger.<sup>36</sup> The initial steps in this harmonization can be accomplished without congressional action. Further, both the House Reform Bill and the Senate Reform Bill include provisions calling for collaboration or consultation between the SEC and CFTC.<sup>37</sup>

### B. *Operational Reform Proposals and Initiatives*

Many organizational reform proposals emanating from the financial crisis fall short of structural changes in securities regulation. Instead, these proposals have called for modifications to the policies or procedures of the SEC or its individual operating units. Post-crisis suggestions for and implementation of operational changes have ranged from the Obama Reform Plan’s harmonization of the regulatory operations of the SEC and CFTC,<sup>38</sup> through the types of collaboration and consultation represented in the House Reform Bill and the Senate Reform Bill<sup>39</sup> and targeted enhancements in SEC personnel coincident with and following the establishment of the Obama administration,<sup>40</sup> to the reorganization of the Division

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33. See OBAMA REFORM PLAN, *supra* note 27, at 10, 12, 36-37.

34. See TREASURY BLUEPRINT, *supra* note 23, at 11 (“[T]he CFTC and the SEC should be merged to provide unified oversight and regulation of the futures and securities industries.”); *id.* at 115-16 (discussing merger).

35. *Id.* at 11-12.

36. See OBAMA REFORM PLAN, *supra* note 27, at 4, 49-51.

37. See sources cited *supra* note 28.

38. See *supra* note 27 and accompanying text.

39. See *supra* note 28 and accompanying text.

40. In addition to the appointment of a new SEC Chair and a new Director of the Division of Enforcement, the SEC has recruited and hired specialized staff, including most recently new unit heads. See Press Release, U.S. Sec. & Exch. Comm’n, SEC Names New Specialized Unit Chiefs and Head of New Office of

of Enforcement and additional training for its staff.<sup>41</sup> Although action on some proposals has been delayed or derailed, a number of these proposals are being implemented or have the prospect of being implemented in the near future.<sup>42</sup> A list of ongoing SEC reform efforts can be found on the SEC's Web site.<sup>43</sup>

These reforms reach into many aspects of the SEC's operations, but most prevalently touch the operations of the Division of Enforcement and its Office of Compliance Inspections and Examinations. The Division of Enforcement has been under especially close scrutiny in the twenty-first century in the wake of revelations of financial fraud at Enron Corporation, WorldCom, Inc., and other public company issuers.<sup>44</sup> Most recently, the Division was criticized for failing to earlier recognize the financial peril in which investment banks found themselves and to earlier identify and shut down the massive Ponzi scheme perpetrated by Bernard Madoff and the securities fraud committed by R. Allen Stanford.<sup>45</sup> The Madoff affair prompted a detailed investigation and report from the Office of the Inspector General of the SEC (OIG),<sup>46</sup> together with a related set of recommendations.<sup>47</sup> The OIG's twenty-one recommendations include suggestions for improvements in: the handling of tips and complaints; staff training; periodic policy and procedure reviews; and specific operating procedures relating to, among other things, staff communications, re-

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Market Intelligence (Jan. 13, 2010), available at <http://www.sec.gov/news/press/2010/2010-5.htm>.

41. See *The SEC's Failure to Identify the Bernard L. Madoff Ponzi Scheme and How to Improve SEC Performance: Testimony Before the S. Comm. on Banking, House, and Urban Affairs*, 111th Cong. (2009) (statement of Robert Khuzami, Director, Division of Enforcement, and John Walsh, Acting Director, Office of Compliance Inspections and Examinations) [hereinafter *Madoff Failure Testimony*], available at <http://www.sec.gov/news/testimony/2009/ts091009rk-jw.htm>; Kevin McCoy, *SEC Investigations to get tougher; Madoff debacle prompts many recommendations*, USA TODAY, Sept. 11, 2009, at 3B; see also *infra* notes 42-49 and accompanying text.

42. See Fawn Johnson, *Group Alleges Slack SEC Response To Internal Watchdog*, NASDAQ, Jan. 22, 2010, <http://www.nasdaq.com/aspx/stock-market-news-story.aspx?storyid=200912171553dowjonesdjonline000580&title=group-alleges-slack-sec-response-to-internal-watchdog>; Jesse Westbrook, *Wall Street Waits as SEC Fails to Bring Madoff-Inspired Reforms*, BLOOMBERG.COM, Dec. 30, 2009, [http://www.bloomberg.com/apps/news?pid=20601109&sid=afUo\\_v51Emwc](http://www.bloomberg.com/apps/news?pid=20601109&sid=afUo_v51Emwc).

43. See *The Securities and Exchange Commission: Post-Madoff Reforms* (Dec. 7, 2009), <http://www.sec.gov/spotlight/secpostmadoffreforms.htm>.

44. See Editorial, *Of Madoff, Stanford and SEC*, USA TODAY, Feb. 19, 2009, available at <http://blogs.usatoday.com/oped/2009/02/of-madoff-stanf.html>.

45. See *id.*; Stephen Labaton, *S.E.C. Chief Pursues Reversal of Years of Lax Enforcement*, N.Y. TIMES, Feb. 23, 2009, at B1.

46. See OFFICE OF THE INSPECTOR GEN., U.S. SEC. & EXCH. COMM'N, REVIEW AND ANALYSIS OF OCIE EXAMINATIONS OF BERNARD L. MADOFF INVESTMENT SECURITIES, LLC (2009), available at <http://www.sec-oig.gov/Reports/AuditsInspections/2009/468.pdf>.

47. See OFFICE OF THE INSPECTOR GEN., U.S. SEC. & EXCH. COMM'N, PROGRAM IMPROVEMENTS NEEDED WITHIN THE SEC'S DIVISION OF ENFORCEMENT (2009), available at <http://www.sec-oig.gov/Reports/AuditsInspections/2009/467.pdf>.

source allocation, information validation and documentation.<sup>48</sup> In addition, the OIG recommends that the Division of Enforcement (1) further analyze staff concerns about the “communication of program priorities,” “case handling procedures,” and internal “working relationships” and (2) identify and propose responsive improvements.<sup>49</sup>

## II. FOUR IMPORTANT LESSONS FROM CHANGE LEADERSHIP LITERATURE AND THEIR APPLICATION TO CURRENT SEC REFORM PROPOSALS AND INITIATIVES

The summary of proposed reforms in Part I illustrates the intense scrutiny that the SEC has been under in the past few years. With the election of Barack Obama as the forty-fourth President of the United States came a change in leadership at the SEC. Mary Schapiro was sworn into office as the twenty-ninth Chairman of the SEC on January 27, 2009.<sup>50</sup>

Leading change is a tricky business. Given that success in organizational change is a low-probability proposition,<sup>51</sup> business scholars have observed, theorized, and tested certain aspects of organizational change to try to determine predictors of success or failure. This part summarizes four lessons from the resulting change leadership literature and applies them to current SEC reform proposals and efforts.

### A. *It Is Important that Organizations Select the Right Change Leaders to Best Ensure Success in Organizational Change*

A person is a leader because he or she engenders followers.<sup>52</sup> A person follows a leader based on emotion.<sup>53</sup> Leaders convincingly communicate a positive message that counteracts a negative feeling in a community or other population; “[t]hey are people whom others perceive as being able to make things better. . . . Ultimately, leaders lead because they create a passionate commitment in other people to pursue the leader’s strategy and succeed.”<sup>54</sup>

Effective change requires leadership.

Managing change is important. . . . But for most organizations, the much bigger challenge is leading change. Only leadership can blast through the many sources of . . . inertia. Only leadership can motivate the actions needed to alter behavior in any sig-

48. *See id.* at iii-v, 3-19.

49. *Id.* at vi, 19-27.

50. *See* SEC Biography: Chairman Mary L. Schapiro (Feb. 23, 2009), <http://www.sec.gov/about/commissioner/schapiro.htm>.

51. For discussion of success in organizational change, see *supra* note 8 and accompanying text.

52. *See* Judith M. Bardwick, *Peacetime Management and Wartime Leadership*, in *THE LEADER OF THE FUTURE* 131, 138-39 (Frances Hesselbein et al. eds., 1996).

53. *See id.*

54. *Id.* at 139.

nificant way. Only leadership can get change to stick by anchoring it in the very culture of an organization.<sup>55</sup>

Accordingly, a threshold matter in organizational change efforts is the identity of the change leader.

It is important to observe at the outset that we choose SEC commissioners, unit leaders, and staff (as well as other related elected and appointed officials who may be involved in leading and implementing SEC reform efforts) the same way, regardless of the social, economic, and political climate in which they will work. Yet, leaders in times of change may require different attributes and skills than those who manage in less turbulent times. This means that those engaged in the standard SEC leadership identification and selection process during a crisis of confidence should be sensitive to the need for a specialized type of leader—a change leader—as a means of restoring confidence.

But who are these change leaders? What characteristics do they exhibit? Change leadership literature tells us that we should be looking for “wartime leaders”—“people who embrace major change because they see far more opportunity than threat in turbulence”<sup>56</sup>—and “problem-finders”—individuals who “not only exhibit a curious mindset, but . . . also embrace systemic thinking.”<sup>57</sup> It is my hope that this Article will help focus the President, Congress, and high-ranking SEC officials on factors important to leadership choices in times of change.

In her work *Peacetime Management and Wartime Leadership*, management consultant Judith Bardwick observes that times of peace rarely require more than management of incremental change, but times of war—periods of significant disorder fraught with urgent and emergent events and circumstances—require leadership. Bardwick suggests that “peacetime management” is appropriate during an era of organizational predictability, where things continue along the same trajectory.<sup>58</sup> But “wartime leadership” is needed during times of change. Among other things, wartime leaders “get the organization to focus and to become involved only in what matters the most.”<sup>59</sup> In addition, wartime leaders: “create a winning strategy” by focusing on what the organization can do to ensure customer loyalty; “communicate persuasively” using focused, targeted messages; “behave with integrity”; “respect others” by seeking their input, encouraging

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55. JOHN P. KOTTER, *LEADING CHANGE* 30 (1996).

56. Bardwick, *supra* note 52, at 131-39 (defining wartime leaders as “people who embrace major change because they see far more opportunity than threat in turbulence” and describing six things that they must do to achieve success).

57. MICHAEL A. ROBERTO, *KNOW WHAT YOU DON’T KNOW: HOW GREAT LEADERS PREVENT PROBLEMS BEFORE THEY HAPPEN* 191 (2009); see also *The Mindset of a Problem-Finder*, KNOWLEDGE@WHARTON, July 15, 2009, <http://knowledge.wharton.upenn.edu/article.cfm?articleid=2285> (reviewing *KNOW WHAT YOU DON’T KNOW*, *supra*).

58. See Bardwick, *supra* note 52, at 132.

59. *Id.* at 134.

debate, and demanding alignment with the resulting decisions; and take action to show decisiveness and strength as a means of inspiring confidence in organizational constituents.<sup>60</sup> Among these attributes, persuasive communication seems to be a key factor that both reflects and creates the trust that bonds the leader to his or her followers.

People trust others when they are told that something will happen and it does. Major change, therefore, always threatens trust and thus, ultimately, confidence in leadership. Ineffective or non-existent communication results in an enormous increase in mistrust, confusion, and cynicism and huge decline in morale, belief in the organization, and confidence in leadership. That's why the need for persuasive communication is especially critical in periods of major threat or change.<sup>61</sup>

Are SEC Chairman<sup>62</sup> Mary Schapiro and Division of Enforcement Director Robert Khuzami "wartime leaders"? While it may be too early to tell, both have exhibited characteristics of wartime leaders.<sup>63</sup> Both moved quickly to identify focused reform initiatives and begin implementing changes that addressed the existing lack of public confidence in the SEC, both have prioritized the implementation of reform proposals and focused the organization around those priorities, and both have shown persuasive communication skills.<sup>64</sup> The SEC leadership has conducted a self-assessment of the Division of Enforcement as part of its reform strategy, and Director Khuzami has revisited the effects of the resulting decisions with the Division's employees.<sup>65</sup> Current indications therefore support

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60. *Id.* at 134-38.

61. *Id.* at 136.

62. My use of the word "Chairman" in this Article to describe the female leader of the SEC is purposeful, even if uncomfortable. The SEC's Web site identifies Mary Schapiro as the SEC Chairman. I hope that our federal government will consider adopting gender-neutral ("Chair")—or at least gender-accurate ("Chairwoman")—descriptors for its leadership.

63. *See supra* notes 52-61 and accompanying text.

64. *See, e.g.*, Jenna Greene, *New Enforcement Chief Aims to Restore Confidence in SEC*, NAT'L LAW J., Oct. 20, 2009, available at <http://www.law.com/jsp/article.jsp?id=1202434751457>; Robert Khuzami, Dir., Div. of Enforcement, U.S. Sec. & Exch. Comm'n, Remarks at AICPA National Conference on Current SEC and PCAOB Developments (Dec. 8, 2009) (transcript available at <http://www.sec.gov/news/speech/2009/spch120809rsk.htm>) [hereinafter Khuzami, AICPA Remarks]; Mary L. Schapiro, Chairman, U.S. Sec. & Exch. Comm'n, Alan B. Levenson Keynote Address at the 37th Annual Securities Regulation Institute: Embracing the Change (Jan. 20, 2010) (transcript available at <http://www.sec.gov/news/speech/2010/spch012010mls.htm>) [hereinafter Schapiro, Embracing Change]; Stephen Taub, *Mary Schapiro Puts SEC Back in Business*, INSTITUTIONAL INVESTOR, Nov. 2009, <http://www.iimagazine.com/article.aspx?articleID=2333948>; Rachele Younglai, *SEC Chief Says Agency to Act Like "Hair's on Fire,"* REUTERS, Feb. 6, 2009, <http://www.reuters.com/article/idUSTRE51548J20090206>; Rachele Younglai, *SEC's Tough New Cop Seen Helping Agency's Image*, REUTERS, Apr. 10, 2009, <http://www.reuters.com/article/idUSTRE5392JU20090410>.

65. *See infra* notes 75-76 and accompanying text.

the conclusion that both Chairman Schapiro and Director Khuzami are wartime leaders.

Wartime leadership may be a necessary but insufficient condition to accomplishing effective change leadership, however. Recent change leadership literature also points to the value of “problem-finders” in successfully leading an organization through tough times with integrity. Effective problem-finders engage questions and criticism; they pursue potential issues with deeper analysis to isolate trouble early on.

[L]eaders need to become hunters who venture out in search of the problems that might lead to disaster for their firms. They cannot wait for the problems to come to them. Time becomes the critical factor. The sooner leaders can identify and surface problems, the more likely they can prevent a major catastrophe. If leaders spot the threats early, they have more time to take corrective action. They can interrupt a chain of events before it spirals out of control.<sup>66</sup>

Successful problem-finders exhibit seven behavioral characteristics.<sup>67</sup> Specifically, they: (1) circumvent gatekeepers by going directly to the source for information; (2) act as ethnographers by observing how relevant populations (employees, customers, suppliers) actually behave; (3) hunt for patterns, including parallels to events from the past; (4) connect the dots, integrating “critical data and knowledge”; (5) encourage useful failures to promote risk-taking and reduce the fear of failure; (6) train employees in effective, appropriate communication—that is, “how to talk and listen”; and (7) reflect systematically on the organization and its competitors.<sup>68</sup>

Problem-finding seems to have been in short supply at the SEC in recent years. In theory, with problem-finders as leaders, the SEC could have sooner identified major problems such as the financial shenanigans at Enron and WorldCom, the precarious financial state of U.S. investment banks in 2007-2008, and the fraudulent activities of Bernard Madoff, R. Allen Stanford, and others. Knowledgeable commentators have noted the need for the SEC to become more nimble at problem-finding.<sup>69</sup> SEC leaders who are problem-finders have the capacity to better ensure the dual fundamental policy objectives under the federal securities laws: investor protection and market integrity maintenance.

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66. ROBERTO, *supra* note 57, at xviii.

67. *See id.* at 19-20 (summarizing these behaviors, which are covered in detail in the remainder of the book).

68. *Id.*

69. *See* Jonathan Stempel & Rachele Younglai, *SEC Checklist: Fix the Mess, Find the Next Madoff*, REUTERS, Sept. 4, 2009, <http://www.reuters.com/article/idUSTRE5834AC20090905> (noting comments from former SEC Branch Chief Michael MacPhail and former SEC Commissioner Harvey Goldschmid to that effect).



So, are our new SEC leaders “problem-finders”? This is a difficult question to answer in the absence of detailed information about how Chairman Schapiro and Director Khuzami operate in their day-to-day engagements with peers and staff. Observations are mixed. At the time of her appointment over a year ago, a commentator said the following about Chairman Schapiro:

Do I think that she has the personality and the chops to take on that assignment? Candidly, I just don't know. A lot of what she did at NASD/FINRA is commendable, but not everything; and I can speak with personal knowledge that she failed to recognize the size and conviction of the dissident/reform movement within the indie/regional broker-dealer community.<sup>70</sup>

Moreover, early reforms she initiated at the SEC that put more power and discretion in the hands of SEC staff did not engender confidence that she was increasing the staff's capacity for problem-finding.<sup>71</sup> On the other hand, in an October 2009 speech, Chairman Schapiro noted reforms in her first nine months in office that appear to emanate from and encourage problem-finding skills.<sup>72</sup> She also appeared to recognize the need for problem-finding on an ongoing basis, opining that “[w]ith greater stability in the markets, we can begin choosing the issues, rather than having them choose us.”<sup>73</sup>

In the same speech, Chairman Schapiro highlighted personnel and operational reforms instituted by Director Khuzami that also appear to promote problem-finding:

He removed a layer of management, which will result in the redeployment of dozens of superbly qualified attorneys back to the front lines, and created specialized units—units where attorneys can concentrate their expertise in a particular area—such as structured products or market abuse—and better detect links and patterns that might not have been spotted before.<sup>74</sup>

These changes follow on a self-assessment conducted within the SEC Division of Enforcement.<sup>75</sup> Self-assessment, if done properly, incorporates the

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70. Davis Serchuk, *Is Schapiro Enough for the SEC?*, FORBES, Dec. 19, 2008, <http://www.forbes.com/2008/12/18/intelligent-investing-sec-schapiro-madoff-panelDec19.html>.

71. *See Just Don't Mention Bernie*, WALL ST. J., Feb. 10, 2009, at A16.

72. *See* Mary Schapiro, Chairman, U.S. Sec. & Exch. Comm'n, *The Road to Investor Confidence*, Speech Before the SIFMA Annual Conference (Oct. 27, 2009) (transcript available at <http://www.sec.gov/news/speech/2009/spch102709mls.htm>) [hereinafter Schapiro, *Investor Confidence*].

73. *Id.*

74. *Id.*

75. *See* Khuzami, AICPA Remarks, *supra* note 64; *see also* Jessica Holzer, *SEC's Khuzami: Enforcement Unit Undergoing 'Self-Assessment'*, ACCOUNTING & COMPLIANCE

seven behaviors necessary to effective problem finding.<sup>76</sup> Public reports, however, cast doubt on whether the personnel changes, in particular, reflect expert ethnographic problem-finder skills.<sup>77</sup>

B. *Success in Organizational Change Follows Recognizable Patterns*

Harvard Business School Professor John Kotter is well known for identifying a pattern for leading successful organizational change.<sup>78</sup> Yet, we cannot be sure that the President, members of Congress, and key Federal Reserve, Department of the Treasury, and SEC personnel (including Chairman Schapiro and Director Khuzami) are familiar with this work and with other similar guidance from change leadership literature. And even if some or all of the change agents impacting a restructuring of the SEC are familiar with this work, it is unclear whether any of those change agents are consciously using this learning and incorporating useful elements from Kotter's books into the SEC reorganization process. Studies of organizational change have shed significant light on the elements of a successful reform effort. Leaders effectuating reform at the SEC do not have to "reinvent the wheel" as they initiate, manage, and institutionalize organizational change.

Kotter's model is organized into eight stages designed to address eight observed mistakes made in efforts for organizational change: "establishing a sense of urgency"; "creating the guiding coalition"; "developing a vision and strategy"; "communicating the change vision"; "empowering broad-based action"; "generating short-term wins"; "consolidating gains and producing more change"; and "anchoring new approaches in the culture."<sup>79</sup> Each stage has identifiable characteristics. This part of the Article will describe each stage in turn and assess whether the two key change leaders involved in the SEC reform effort—specifically, Chairman Schapiro and Director Khuzami—appear to have engaged or be engaging, whether consciously or unconsciously, the elements of that stage. Progress has been made in six of the eight stages to date. The seventh and eighth stages are ongoing as this Article is being written.

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INT'L, Dec. 16, 2009, <http://www.acisecure.com/articles/sec-s-khuzami-enforcement-unit-undergoing-self-assessment>.

76. See *supra* notes 67-68 and accompanying text.

77. See Zachary A. Goldfarb, *SEC Upsets Some as It Tries to Sharpen Teeth; Several Moves Draw In-House Criticism*, WASH. POST, July 15, 2009, at A13 ("Schapiro and her enforcement director, Robert Khuzami, have undertaken a series of personnel changes that employees say are causing turmoil within the enforcement division and posing a distraction from its work investigating financial crime. Khuzami has two meetings scheduled today with employees to discuss these moves."). The same article also notes, however, a renewed sense of pride among employees in the Division of Enforcement. See *id.* ("[H]eightened activity has prompted renewed pride inside the enforcement division even as personnel changes are fueling disenchantment, employees say.").

78. See generally KOTTER, *supra* note 55 (articulating a framework for successful organizational change comprised of eight stages).

79. *Id.* at 21 (summarizing the eight-stage process of creating major change).

1. *Establishing a Sense of Urgency*

“Visible crises can be enormously helpful in catching people’s attention and pushing up urgency levels.”<sup>80</sup> To be sure, the SEC has experienced visible crises over the past few years. Admissions of significant failures at the SEC extend back over more than two years’ time and cover multiple areas of SEC operations.<sup>81</sup> “The natural superiority of the U.S. model for securities regulation is no longer an article of faith, and the credibility of the SEC as a financial regulator has never been lower.”<sup>82</sup>

[A]lthough the SEC has long been “the crown jewel of the financial regulatory infrastructure,” recent developments have called that characterization into question. The SEC has been the target of relentless criticism ranging from claims that it mishandled derivatives regulation, oversight of securities firms, and market risk, to assertions of delays and blunders and possible industry capture at the Division of Enforcement. These criticisms followed the Treasury Department’s Blueprint of Financial Regulation—released in March 2008—that criticized the SEC’s approach to regulation as obsolete and proposed a plan of regulatory consolidation that would effectively lead to the agency’s demise. Most recently, the revelation that the SEC failed to discover a \$50 billion Ponzi scheme at Madoff Investment Securities, despite having received allegations of wrongdoing for over a decade, suggests fundamental weaknesses in its core enforcement operations.<sup>83</sup>

To be successful at organizational change, however, a change leader must use the crisis to shake up the organization. This requires that the change leader “remove sources of complacency or minimize their impact”<sup>84</sup> and take actions that are “bold or even risky.”<sup>85</sup> Kotter uses the concept of fire in a building as a proxy for crisis in an organization, writing that “[c]onducting business as usual is very difficult if the building seems to be on fire.”<sup>86</sup> Interestingly, Chairman Schapiro invoked fire imagery in comments to reporters as she made changes to SEC operations shortly

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80. *Id.* at 45.

81. *See, e.g.*, Brady Dennis, *SEC and FDIC Acknowledge Agencies’ Lapses*, WASH. POST, Jan. 15, 2010, at A18; Stephen Labaton, *S.E.C. Concedes Oversight Flaws Fueled Collapse*, N.Y. TIMES, Sept. 27, 2008, at A1.

82. Coffee & Sale, *supra* note 1, at 708.

83. Jill E. Fisch, *Top Cop or Regulatory Flop? The SEC at 75*, 95 VA. L. REV. 785, 785-786 (2009) (footnotes omitted).

84. KOTTER, *supra* note 55, at 42.

85. *Id.* at 42-43.

86. *Id.* at 45.

after taking office.<sup>87</sup> Moreover, in a recent speech, Chairman Schapiro noted the rapid pace of change at the SEC over the preceding year:

I know that change is hard because within our agency we have been engaged in some of the most significant change in decades. When I arrived at the agency last January, we began a process of assessing our operations and determined we could do better. We determined that we needed to change. And that is the path we have chosen.<sup>88</sup>

Director Khuzami also has noted the need for speed as part of the reform efforts within the Division of Enforcement at the SEC, noting that “[a] sense of urgency is critical. Long gaps between conduct and atonement undermine the deterrent impact of our cases, and result in missed opportunities to achieve a permanent change in behavior and culture.”<sup>89</sup>

The personnel changes instituted at the SEC may be seen as examples of sweeping change.<sup>90</sup> The discomfort and discontent of the SEC staff in response to the personnel changes may be evidence of the brash nature of these personnel changes.<sup>91</sup> Kotter’s work predicts this kind of reaction. He notes that “[b]old moves that reduce complacency tend to increase conflict and to create anxiety, at least at first.”<sup>92</sup>

## 2. *Creating the Guiding Coalition*

Leading change is not a solitary task.

Because major change is so difficult to accomplish, a powerful force is required to sustain the process. No one individual, not even a monarch-like CEO, is ever able to develop the right vision, communicate it to large numbers of people, eliminate all the key obstacles, generate short-term wins, lead and manage dozens of change projects, and anchor new approaches deep in the organization’s culture.<sup>93</sup>

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87. See Younglai, *supra* note 64 (“I like to tell the staff we are going to act like our hair is on fire.”).

88. Schapiro, *Embracing Change*, *supra* note 64.

89. Robert Khuzami, Dir., Div. of Enforcement, U.S. Sec. & Exch. Comm’n, *My First 100 Days as Director of Enforcement, Remarks Before the New York City Bar*, (Aug. 5, 2009) (transcript available at <http://www.sec.gov/news/speech/2009/spch080509rk.htm>) [hereinafter Khuzami, *First 100 Days*].

90. See *supra* notes 64-65, 70-77, and accompanying text.

91. See *supra* note 77 and accompanying text. In recent public remarks, Chairman Schapiro noted that her overall change efforts have been hard on her staff. See Schapiro, *Embracing Change*, *supra* note 64 (“None of this is easy for a dedicated staff that was already focused on doing its job in a tumultuous time. Yet, through it all the staff has embraced the change because we all appreciate the importance of restoring confidence and protecting investors.”).

92. KOTTER, *supra* note 55, at 43.

93. *Id.* at 51-52. Business leadership author Jim Collins agrees that successful change leaders put a guiding coalition into place early in the organizational change process. See JIM COLLINS, *GOOD TO GREAT* 41 (2001). He writes,

Instead, what is required is a strong leadership team—a team “with the right composition and sufficient trust among members.”<sup>94</sup> In terms of composition, “four key characteristics” are important: “position power”—the entire group who will be charged with making progress in areas of needed change, “expertise,” “credibility,” and “leadership.”<sup>95</sup> Trust is borne of activities that “create . . . mutual understanding, respect, and caring.”<sup>96</sup> Trust is important because it can lead to the effective creation of a “common goal” or “shared objective.”<sup>97</sup>

Chairman Schapiro has changed the leadership team at the SEC.<sup>98</sup> We must question, however, whether the team has the right characteristics and the requisite trust. Certainly, the credentials of the SEC Commissioners are quite impressive in terms of expertise, credibility, and leadership skills.<sup>99</sup> Director Khuzami appears to have all four key guiding coalition characteristics based on the role he has played to date and published reports.<sup>100</sup> Chairman Schapiro has put a premium on attracting to the SEC people with an expansive set of experiences and skills.<sup>101</sup> Moreover, the published remarks of new leaders in the Division of Enforcement—people with position power—are impressive in their indication of a collective change momentum.<sup>102</sup> New leaders continue to emerge, making the membership of the guiding coalition unsettled and unclear.

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The executives who ignited the transformations from good to great did not first figure out where to drive the bus and then get people to take it there. No, they *first* got the right people on the bus (and the wrong people off the bus) and *then* figured out where to drive it.

*Id.*

94. *Id.* at 55.

95. *Id.* at 57.

96. *Id.* at 62.

97. *Id.* at 65.

98. See Schapiro, Embracing Change, *supra* note 64 (“[W]e brought on new leadership across the SEC committed to revitalizing and reenergizing the agency, working collaboratively, and thinking creatively about the tools we have to effect positive change.”).

99. See Current SEC Commissioners (Feb. 23, 2009), <http://www.sec.gov/about/commissioner.shtml> (providing brief biographies of Commissioners).

100. See *Khuzami Will Lead SEC Enforcement*, WALL ST. J., Feb. 20, 2009, at C3; Kara Scannell, *Crisis on Wall Street: SEC Expected to Name Khuzami Enforcement Director*, WALL ST. J., Feb. 9, 2009, at C3; David Scheer & Jesse Westbrook, *SEC Names Ex-Prosecutor Khuzami to Head Enforcement*, BLOOMBERG.COM, Feb. 19, <http://www.bloomberg.com/apps/news?pid=20601087&sid=ag0xTeE.ikGw&refer=home>; Press Release, U.S. Sec. & Exch. Comm’n, Robert Khuzami Named SEC Director of Enforcement (Feb. 19, 2009), available at <http://www.sec.gov/news/press/2009/2009-31.htm>.

101. See *Madoff Failure Testimony*, *supra* note 41; Mary L. Schapiro, Chairman, U.S. Sec. & Exch. Comm’n, Applying the Lessons, Speech Before the Harvard University John F. Kennedy School of Government (Nov. 5, 2009) (transcript available at <http://www.sec.gov/news/speech/2009/spch110509mls.htm>) (“At the SEC, one of the things I’ve been trying to do is bring on board more people with non-traditional skill sets and backgrounds.”) [hereinafter Schapiro, Lessons].

102. See Bruce Kapaty et al., Staff of U.S. Sec. & Exch. Comm’n, Remarks at News Conference Announcing New SEC Leaders in Enforcement Division (Jan.

In general, public information sources are not detailed enough to enable a comprehensive assessment of the suitability of the composition of Chairman Schapiro's guiding coalition. For example, according to Kotter, "[y]ou need both management and leadership skills on the guiding coalition, and they must work in tandem, teamwork style."<sup>103</sup> He offers matrices that illustrate optimal compositions. Publicly available information does not enable us to determine whether or not the SEC guiding coalition has the optimal balance of management and leadership skills. Only as the exact identity of the leadership team emerges and the team takes concerted and coordinated action will we be able to evaluate its composition.

As difficult as it is for us to appraise the team's composition, it is more difficult for us to assess whether the guiding coalition has the required trust. Although I have not found evidence that ostensible members of the SEC guiding coalition have engaged in team-building exercises or attended a retreat at which intra-group trust may have been engendered,<sup>104</sup> the SEC's recent self-assessment<sup>105</sup> may be a sign that mutual trust is being promoted throughout the agency. As new people are identified for inclusion on the change leadership team, they will need to be effectively brought into the "circle of trust."<sup>106</sup>

### 3. *Developing a Vision and Strategy*

To achieve successful organizational change, a leader needs to have both vision and a strategy to implement that vision. "Vision refers to a picture of the future with some implicit or explicit commentary on why people should strive to create that future."<sup>107</sup> Vision serves to channel change in a particular direction and incentivizes and coordinates change in that direction.<sup>108</sup>

Chairman Schapiro seems to understand this aspect of change leadership, and she also seems to be incorporating it into the SEC's operations. Her vision for a reformed SEC refocuses the SEC's activities on one of the key policy underpinnings of the federal securities laws: investor protection.<sup>109</sup>

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13, 2010) (transcript available at <http://www.sec.gov/news/speech/2010/spch011310newsconf.htm>).

103. KOTTER, *supra* note 55, at 57.

104. *See id.* at 62-64.

105. *See supra* notes 75-76 and accompanying text.

106. Although this term is widely used, it is perhaps most amusingly associated in modern memory with *Meet the Parents* (2000) and *Meet the Fockers* (2004), two Universal Pictures comedy films directed by Jay Roach. *See* The Internet Movie Database, *Meet the Parents*, <http://www.imdb.com/title/tt0212338/> (last visited May 29, 2010); The Internet Movie Database, *Meet the Fockers*, <http://www.imdb.com/title/tt0290002/> (last visited May 29, 2010).

107. KOTTER, *supra* note 55, at 68.

108. *See id.* at 68-69.

109. *See, e.g.*, James D. Cox, *Premises for Reforming the Regulation of Securities Offerings: An Essay*, 63 LAW & CONTEMP. PROBS. 11, 12 (2000) ("Whether it is the

[A]nother lesson I have learned is to have a vision about where you want to take your organization and stick to your principles in getting there.

Principles are not ideologies. They are different. Maybe it's a question of degree. Maybe to some it's semantics. But as I see it, unlike ideologies, principles don't seem to demand a particular answer to every problem that emerges.

We've seen how strict adherence to ideology played out over the last decade in the financial arena. "Free market ideology" together with rapidly changing technology, globalization and many other accidental causes led too many of us to forget hard-learned lessons from past crises and abandon basic common sense.

Principles, on the other hand, help frame a question, an issue or a problem. Having a principle might highlight tensions and tradeoffs of particular choices, but rarely do they force you to choose between a good solution and a worldview.

For me at the SEC, my main principle is *putting investors first*. And, I try to stay focused on that every day. And the goal is to build an SEC that is deeply expert, nimble, and aggressive—that gives investors confidence.

In fact, as Bob Glauber can attest, I have a sign posted on my door that says "How does it help investors?" It's a simple question, but it guides all that I do at the SEC. And, all those who enter my office understand that is the prism through which we will consider all issues.

It doesn't necessarily dictate the outcome of every issue that lands on my desk—because there are many solutions to any problem that could aid investors. But, the principle helps to shape our thinking and steers us in the right path.<sup>110</sup>

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debates within Congress or the frequent expressions of courts, the incantations regarding the broad objective of the securities laws are the same: to provide full and fair disclosure for the protection of investors and to enhance the allocational efficiency of U.S. capital markets."); Jill E. Fisch, *Start Making Sense: An Analysis and Proposal for Insider Trading Regulation*, 26 GA. L. REV. 179, 227 (1991) (noting that "the overall structure and objectives of the federal securities laws, . . . are aimed primarily at the protection of investors and the capital markets"); Tamar Frankel, *The Internet, Securities Regulation, and Theory of Law*, 73 CHI.-KENT L. REV. 1319, 1324 n.16 (1998) ("Underlying the securities laws are two paramount policies: the policy of protecting investors, designed to entice investors to put their money at risk in the markets, and the policy of facilitating capital formation, designed to assist issuers in raising capital."); Donna M. Nagy, *Reframing the Misappropriation Theory of Insider Trading Liability: A Post-O'Hagan Suggestion*, 59 OHIO ST. L.J. 1223, 1228 (1998) (referencing "the investor protection and market integrity policy objectives underlying the federal securities laws").

110. Schapiro, Lessons, *supra* note 101.

Vision is implemented through strategy.<sup>111</sup> “Without vision, strategy making can be a much more contentious activity. . . . Even more so, without good vision, a clever strategy or a logical plan can rarely inspire the kind of action needed to produce major change.”<sup>112</sup> Chairman Schapiro’s vision has guided structural and operational change at the SEC as well as substantive rulemaking. Some credit her clearly conceived vision and the related rapidly employed strategy for saving the SEC from more significant structural or operational change.<sup>113</sup>

#### 4. *Communicating the Change Vision*

According to Kotter, the larger the audience for the change vision, the more powerful it may be.

A great vision can serve a useful purpose even if it is understood by just a few key people. But the real power of a vision is unleashed only when most of those involved in an enterprise or activity have a common understanding of its goals and direction. That shared sense of a desirable future can help motivate and coordinate the kinds of actions that create transformations.<sup>114</sup>

A leader must be careful to communicate the change vision broadly, frequently (repeatedly), and consistently.<sup>115</sup> The message conveying the vision must be direct, clear, simple, and geared to its targeted audiences.<sup>116</sup> Metaphors, analogies, examples, and florid prose may be helpful in this regard.<sup>117</sup> The means of conveying the message should be varied: oral and written, large forum and small group, and through words and actions.<sup>118</sup> Finally, to ensure understanding, the communication of the vision should be a two-way street, involving both give and take as well as conveying and listening.<sup>119</sup>

Chairman Schapiro and Director Khuzami, in particular, have engaged in significant public speaking in which they have regularly and repeatedly informed and reminded the SEC staff and various elements of the public about the SEC’s recommitment to investor protection and the

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111. See KOTTER, *supra* note 55, at 75 (“Strategy provided both a logic and a first level of detail to show how a vision can be accomplished.”).

112. *Id.* at 71.

113. See Taub, *supra* note 64.

114. KOTTER, *supra* note 55, at 85.

115. See *id.*; see also *id.* at 94 (“[E]ffective information transferral almost always relies on repetition.”); *id.* at 97-99 (extolling the virtues of addressing seeming inconsistencies).

116. See *id.* at 89. This is analogous to the “hedgehog concept” described by business leadership author Jim Collins. See COLLINS, *supra* note 93, at 91 (“Hedgehogs . . . simplify a complex word into a single organizing idea, a basic principle or concept that unifies or guides everything.”).

117. See *id.* at 91-92.

118. See *id.* at 93, 95-97.

119. See *id.* at 99-100.



linkage of that vision to structural and operational changes at the SEC.<sup>120</sup> These speeches are all transcribed and available on the SEC's Web site.<sup>121</sup> Of course, Chairman Schapiro also regularly appears before congressional committees and subcommittees, and she has communicated her vision in these arenas as well.<sup>122</sup> She and Director Khuzami have used memorable analogies, examples, and words to convey the SEC's organizational change message.<sup>123</sup> Evidencing an appreciation for two-way communication, soon after her appointment, Chairman Schapiro took action in response to staff suggestions that enforcement efforts against corporate violators of the securities laws were too difficult.<sup>124</sup> Moreover, the self-assessment process and related ongoing staff communications are evidence of two-way com-

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120. See, e.g., Khuzami, *First 100 Days*, *supra* note 89; Robert S. Khuzami, Dir., Div. of Enforcement, U.S. Sec. & Exch. Comm'n, Remarks at Department of Justice Press Conference (Nov. 17, 2009) (transcript available at <http://www.sec.gov/news/speech/2009/spch111709rsk.htm>); Robert S. Khuzami, Dir., Div. of Enforcement, U.S. Sec. & Exch. Comm'n, Remarks at News Conference Announcing Enforcement Cooperation Initiative and New Senior Leaders (Jan. 13, 2010) (transcript available at <http://www.sec.gov/news/speech/2010/spch011310rsk.htm>) [hereinafter Enforcement Cooperation and New Senior Leaders]; Mary L. Schapiro, Chairman, U.S. Sec. & Exch. Comm'n, Address to Conference on The Future of Global Finance (Sept. 18, 2009) (transcript available at <http://www.sec.gov/news/speech/2009/spch091809mls.htm>); Mary Schapiro, Chairman, U.S. Sec. & Exch. Comm'n, Address to the Practising Law Institute's 41st Annual Institute on Securities Regulation (Nov. 4, 2009) (transcript available at <http://www.sec.gov/news/speech/2009/spch110409mls.htm>); Mary L. Schapiro, Chairman, U.S. Sec. & Exch. Comm'n, Address to the Society of American Business Editors and Writers (Apr. 27, 2009) (transcript available at <http://www.sec.gov/news/speech/2009/spch042709mls.htm>); Mary L. Schapiro, Chairman, U.S. Sec. & Exch. Comm'n, Building a Stable and Efficient Financial System, Address to the Investment Company Institute, (May 8, 2009) (transcript available at <http://www.sec.gov/news/speech/2009/spch050809mls.htm>); Schapiro, *Embracing Change*, *supra* note 64; Schapiro, *Investor Confidence*, *supra* note 72; Schapiro, *Lessons*, *supra* note 101.

121. See U.S. Securities and Exchange Commission (Home Page), <http://www.sec.gov/> (follow "News & Public Statements" hyperlink; then follow "Speeches and Public Statements" hyperlink).

122. See, e.g., *Testimony Before the S. Subcomm. on Financial Servs. and General Government*, 111th Cong. (2009) (statement of Mary L. Schapiro, Chairman, U.S. Sec. & Exch. Comm'n), available at <http://www.sec.gov/news/testimony/2009/ts060209mls.htm>.

123. See, e.g., Khuzami, *supra* note 87 and accompanying text (describing hair on fire approach); Khuzami, *First 100 Days*, *supra* note 89 (providing examples of key figures' first 100 days in office); Schapiro, *Lessons*, *supra* note 101 (analogizing to favorite professor).

124. See Schapiro, *Embracing Change*, *supra* note 64 ("I believe it sent a message that our staff has a green light to pursue violations and that we have faith in their judgment to do so."); Mary L. Schapiro, Chairman, U.S. Sec. & Exch. Comm'n, Address to Practising Law Institute's SEC Speaks in 2009 Program (Feb. 6, 2009) (transcript available at <http://www.sec.gov/news/speech/2009/spch020609mls.htm>) (announcing the plan to streamline the process of seeking fines against public company violators) [hereinafter Schapiro, SEC Speaks 2009]; see also Marisa McQuilken, *SEC Enforcement Lawyers Say Morale Is Up*, *LEGAL TIMES*, March 2, 2009, <http://www.law.com/jsp/nlj/PubArticleNLJ.jsp?id=1202428712112&slreturn=1&hbxlogin=1>.

munication about the structural and operational changes that have been taking place at the SEC.<sup>125</sup> And Chairman Schapiro has continued to express belief in capturing a variety of viewpoints in decision-making.<sup>126</sup>

##### 5. *Empowering Employees for Broad-Based Action*

To implement the leader's vision, employees need to be able to take action. This may mean clearing away structural barriers, skill deficiencies, systemic obstacles, and supervisory impediments that may forestall effective employee participation in change efforts.<sup>127</sup>

Many of the structural and operational reforms implemented by Chairman Schapiro and Director Khuzami appear to be designed to empower SEC staff members for action that carries forward the change vision of the SEC. The efforts of Chairman Schapiro to listen and respond to staff concerns about unnecessary enforcement hurdles are examples of initiatives to streamline structure.<sup>128</sup> In addition, the restructuring of the Division of Enforcement is geared to clear structural barricades to effective enforcement efforts.<sup>129</sup> The decision to retain staff with "non-traditional skills" and the implementation of new staff training are examples of efforts to remedy skill deficits.<sup>130</sup> Human resources and information systems have been or are being improved in response to deficiencies identified in the SEC's self-assessment and the OIG's investigation, report, and recommendations.<sup>131</sup> In the Division of Enforcement, supervisory positions are being eliminated, supervisory personnel are being replaced, supervisory responsibilities are being realigned, and supervisory attitudes that may have impeded investigations are being corrected.<sup>132</sup>

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125. See *supra* notes 75-76 and accompanying text.

126. See Schapiro, *Lessons*, *supra* note 101.

127. See KOTTER, *supra* note 55, at 102.

128. See *supra* notes 75-76 and accompanying text.

129. See Khuzami, *Enforcement Cooperation and New Senior Leaders*, *supra* note 120 ("Today we are announcing additional steps in our continuing effort to shape an Enforcement Division that is strong, swift and strategic.").

130. See *supra* notes 41 and 101 and accompanying text.

131. See *Madoff Failure Testimony*, *supra* note 41 ("Enforcement is planning to implement a new and more rigorous performance evaluation process for staff and supervisors alike."). "[S]upervisors in the Enforcement division will be required to review regularly caseload reports generated by the Division's newly enhanced case management database." *Id.*; see also *id.* (describing communication and coordination initiatives in the OCIE and Division of Enforcement).

132. See *id.* ("Supervisors at all levels will back up more junior personnel."); Khuzami, *Enforcement Cooperation and New Senior Leaders*, *supra* note 120 (describing structural changes in leadership in the SEC's Division of Enforcement); David Scheer, *SEC Said to Reorganize Enforcement Unit, Trim Management Ranks*, BLOOMBERG.COM, July 7, 2009, <http://www.bloomberg.com/apps/news?pid=20601103&sid=aACDxLXScqEU>.

## 6. *Generating Short-Term Wins*

Because the organizational change process is slow and constituents can be impatient, it is important for a change leader to accomplish certain limited objectives in the short term.

Major change takes time, sometimes lots of time. Zealous believers will often stay the course no matter what happens. Most of the rest of us expect to see convincing evidence that all the effort is paying off. Nonbelievers have even higher standards of proof. They want to see clear data indicating that the changes are working and that the change process isn't absorbing so many resources in the short term as to endanger the organization.<sup>133</sup>

To be effective in sustaining organizational change efforts,<sup>134</sup> short-term wins must be "both visible and unambiguous."<sup>135</sup> They also must be "clearly related to the change effort."<sup>136</sup> And in an effective change effort, they are planned, not accidental.<sup>137</sup>

SEC Chairman Schapiro accomplished some highly publicized early wins after her appointment was confirmed. In particular, she swiftly moved to remove perceived barriers to enforcement of the securities laws against public companies and she appointed Director Khuzami.<sup>138</sup> She publicly promoted these changes, and they were picked up by the news media.<sup>139</sup> These efforts generated support in and outside the SEC.<sup>140</sup>

Similarly, Director Khuzami scored some early, public wins after his appointment. In his first 100 days in office, he conducted a self-assessment of the Division of Enforcement, cleaned house in the Division from a personnel standpoint, and restructured the Division's operations.<sup>141</sup>

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133. KOTTER, *supra* note 55, at 119.

134. *See id.* at 123 (stating that *short-term* wins may serve many roles in supporting change efforts). They may "provide evidence that sacrifices are worth it," "reward change agents with a pat on the back," "help fine-tune vision and strategies," "undermine cynics and self-serving resisters," "keep bosses on board," and "build momentum." *Id.*

135. *Id.* at 121.

136. *Id.* at 122.

137. *Id.* at 124-27.

138. *See supra* note 124 and accompanying text.

139. *See supra* note 124.

140. *See* Nina Easton, *The New Sheriff*, FORTUNE, Mar. 16, 2009, at 122 (noting with favor these short-term wins); McQuilken, *supra* note 124 (noting a prevalent internal reaction in the Division of Enforcement of the SEC); Rachele Younglai, *Unshackled, Wall Street's Cop Goes Hard on Fraud*, DOW JONES FACTIVA, Aug. 14, 2009 ("Lawmakers from both political parties are effusive with praise for Schapiro."). Even SEC gadfly and critic Harry Markopolos expressed support for Chairman Schapiro's efforts. *See* Aaron Pressman, *Madoff Whistleblower Markopolos Blasts SEC*, BLOOMBERG BUSINESSWEEK, June 8, 2009, [http://www.businessweek.com/investor/content/jun2009/pi2009065\\_888396.htm?campaign\\_id=rss\\_daily](http://www.businessweek.com/investor/content/jun2009/pi2009065_888396.htm?campaign_id=rss_daily) ("Amid a hail of criticism he directed at the agency, the reclusive whistleblower went out of his way to praise the SEC's new chairwoman, Mary Schapiro.").

141. *See* Khuzami, *First 100 Days*, *supra* note 89.

More recently, he announced reforms designed to encourage cooperation with the Division by individuals.<sup>142</sup> Most recently, Director Khuzami gave a speech in which he catalogued these and other changes made in his first year as Director of the Division of Enforcement, describing the period of change and increased enforcement as “changing the tires on a moving car.”<sup>143</sup> The key changes made at the Division of Enforcement have generated favorable commentary.<sup>144</sup>

The achievement of these short-term wins on a staggered but consistent basis has kept the SEC’s structural and operational reforms in front of the SEC’s staff and the public, building consensus around and momentum for the SEC’s self-initiated reform efforts and distracting attention from more substantial externally generated suggestions for change.

### 7. *Consolidating Gains and Producing More Change*

The long-term time horizon for organizational change not only makes short-term wins advisable, but also may make early declarations of victory problematic. It is important that the sense of urgency created by the change leaders is sustained for the long haul.<sup>145</sup> “[S]hort-term wins are essential to keep momentum going, but the celebration of the wins can be lethal if urgency is lost. With complacency up, the forces of tradition can sweep back in with remarkable force and speed.”<sup>146</sup>

Although a rapid, consistent pace of change at the SEC has been sustained over these first fifteen months of reform, Chairman Schapiro and Director Khuzami, as well as other SEC change leaders, will need to maintain the change momentum by continuing to introduce reforms on a regular basis. Having come this far, the SEC could lose all of the gains it has made in organizational change merely by relaxing into complacency. “Until changed practices attain a new equilibrium and have been driven into the culture, they can be very fragile.”<sup>147</sup> To reach that equilibrium, in addition to engaging in more and continuous change, the SEC should bring in additional change agents, continue to foster leadership from its senior managers, recruit and nurture project management and leadership from lower ranks in the hierarchy, and identify and decrease or eliminate unnecessary internal structural and operational interconnections that

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142. See Melissa Klein Aguilar, *SEC Enforcement Division Gets Sweeping Makeover*, COMPLIANCE WEEK, Jan. 20, 2010 (explaining SEC may offer credit to individuals and corporations that offer testimony, for example, in form of deferred prosecution agreements and non-prosecution agreements); see also Khuzami, *Enforcement Cooperation and New Senior Leaders*, *supra* note 120.

143. Robert S. Khuzami, Dir., Div. of Enforcement, U.S. Sec. & Exch. Comm’n, *Speech to the Society of American Business Editors and Writers* (Mar. 19, 2010) (transcript available at <http://www.sec.gov/news/speech/2010/spch031910rsk.htm>).

144. See Aguilar, *supra* note 142.

145. See KOTTER, *supra* note 55, at 131-32.

146. *Id.* at 132.

147. *Id.* at 133.

often make change efforts more complex.<sup>148</sup> These types of efforts in change management are difficult and pervasive.<sup>149</sup>

#### 8. *Anchoring New Approaches in the Culture*

Finally, to prevent regression, change leaders must address and resolve any incompatibilities between the changes that have been made and the organization's culture—friction in the group's system of behavioral norms and shared values.<sup>150</sup> This is not as easy as it may sound. These norms and values may apply to the organization as a whole or only to certain parts of the organization, and it is important to achieve compatibility on both levels.<sup>151</sup> Moreover, culture is change-resistant and nearly invisible.<sup>152</sup> Yet, the failure to address inconsistencies between a change effort and the prevailing culture can undo years of reform.<sup>153</sup>

Accordingly, it is important that Chairman Schapiro and Director Khuzami understand the applicable behavioral norms and shared values of the SEC and the Enforcement Division and their respective relevant cultural sub-groups as they continue to reform the SEC and the Enforcement Division. Because the core vision of investor protection should not be entirely inconsistent with the SEC's culture (in whole or in pertinent part), these and other change leaders at the SEC should be able to "graft the new practices onto the old roots while killing off the inconsistent pieces."<sup>154</sup> The important thing will be for the SEC's change leaders to continue to remember the organization's heritage and link it to the organization's new and ongoing operations and objectives.<sup>155</sup>

#### C. *Successful Organizational Change Results from Treating Organizations as Organic, Living Systems*

How a leader engages Kotter's eight stages may be as important as the fact of engaging them. This observation forces us to consider the nature of organizations and how they operate in real life. This reality is a complex one because organizations are not unitary entities.

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148. *See id.* at 143.

149. *See id.* ("Because changing anything of significance in highly interdependent systems often means changing nearly everything, business transformation can become a huge exercise that plays itself out over years . . .").

150. *See id.* at 145-48.

151. *See id.* at 148.

152. *See id.*

153. *See id.*

154. *Id.* at 151.

155. *See id.* at 151-54. Commissioner Schapiro, in particular, has shown signs that she understands this part of the change leadership mission—the linkage of the past to the future. In a November 2009 speech, she talked about restoring the SEC's reputation "to what it once was—a premier regulatory agency within the pantheon of regulators" and referenced "reinvigorating the agency, refocusing the SEC on its core investor-protection mission, and rebuilding investor confidence in our markets." Schapiro, *Lessons*, *supra* note 101.

An organization is made up of individuals who have and exercise certain behavioral freedoms—elements of choice—in conducting the work of the organization.<sup>156</sup> This individualism may make it difficult for group members to listen to a change message and collectively follow its mandates.<sup>157</sup> It is important for change leaders to realize that this difficulty may be less about a failure in communication than about a failure to realize that the organizational change process is faulty because of the leaders' failure to find a shared change vision—one that has significance for and has been internalized by everyone—and common change momentum.<sup>158</sup> People need to be involved in creating the change, not just passively receiving the change message.<sup>159</sup>

This is because organizations tend to behave more like living systems than like machines; they are organic.<sup>160</sup> Change is more likely to be successful if leaders acknowledge this tendency and plan their efforts around four targeted, derivative principles. "These four principles provide very clear indicators of how, within our organizations, we can work with life's natural tendency to learn and change."<sup>161</sup> They represent a collective understanding of the realities of organizational complexity and the interdependence of organizational members.

### 1. *Participation Is Not a Choice*

Change leaders and others in the organization are all part of the organization. The leaders cannot then just pick up a toolbox and fix the organization and be done with the task. Everyone acts together as part of a multifaceted whole, so everyone needs to be actively involved in making organizational change.<sup>162</sup> This means that it is important for SEC change leaders not merely to attempt to impose change on the staff and other personnel, but rather to engage the staff and personnel in the change process. One important way that Chairman Schapiro has begun to do this is by rapidly implementing the staff's own suggestions for change.<sup>163</sup> She also has involved the staff in the change process by enabling them to understand first-hand her change motivation.<sup>164</sup> She has expressly acknowl-

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156. See Rogers & Wheatley, *supra* note 8, at 86-87.

157. See *id.* at 88.

158. See *id.*

159. See *id.* at 89 ("In our experience, enormous struggles with implementation are created every time we *deliver* changes to the organization rather than figuring out how to involve people in their creation.")

160. See *id.* at 84-86.

161. *Id.* at 93.

162. See *id.* at 88; see also Bolman & Deal, *supra* note 8, at 8 ("Without support, training, and chances to participate in the change process, people become a powerful anchor, making forward motion almost impossible.").

163. See *supra* note 124 and accompanying text.

164. See Schapiro, Lessons, *supra* note 101 (describing Chairman Schapiro's interaction with SEC staff). In one of her public appearances, Chairman Schapiro

edged the staff's role in public appearances.<sup>165</sup> Director Khuzami's engagement with Division of Enforcement employees in making structural and operational changes in the Division also has been noted.<sup>166</sup>

## 2. *Life Always Reacts to Directives; It Never Obeys Them*

Communication of the change vision and the strategies or directives to achieve it will result in individualized reactions from those in the organization, but not always "straightforward compliance."<sup>167</sup> An effective change leader will take these varied reactions into account, learn from them, and use them to advance the two-way communication involved in the organizational change process.<sup>168</sup> Although only Chairman Schapiro, Director Khuzami, and their colleagues know what has been communicated and what the various reactions of recipients to those communications may have been, there are indications in public reports of how these change leaders might respond to noncompliance or dissent. In a November 2009 speech, Chairman Schapiro noted the value of different perspectives—diverse viewpoints.<sup>169</sup> In addition, press reports document the fact

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described her engagements with the SEC staff and employees in the creation of change at the SEC.

In September, our Inspector General issued a report that outlined many of the shortcomings that allowed this fraud to go undetected over a number of years. But, even before his report was issued, we set out to understand where we could improve. And, for the past year, we've been re-examining and reforming the way we operate.

. . . [B]y the time the Inspector General's report was issued, we had already had a meaningful head start on the reforms we all agree need to be undertaken.

But rather than sticking that report in a drawer, I knew we needed to learn all we could from it. So I sent it to every one of the 3,700 employees at our agency and encouraged them to read it. And, together with that report I sent along a sampling of the victims' letters—not just for everyone to read about the victims' anger and disappointment, but to remind ourselves about how important it is to do what we do every day—to appreciate the very suffering that our work can prevent.

*Id.*

165. See, e.g., Schapiro, *Embracing Change*, *supra* note 64 ("None of this is easy for a dedicated staff that was already focused on doing its job in a tumultuous time. Yet, through it all the staff has embraced the change because we all appreciate the importance of restoring confidence and protecting investors."); Schapiro, *Lessons*, *supra* note 101 ("At the SEC, we have a staff of incredibly talented men and women."); Schapiro, *SEC Speaks 2009*, *supra* note 124 ("I'd like to take a moment to recognize the many members of the SEC staff who are in attendance today, and thank each and every one of you for your tremendous contributions to public service and investor protection, during extraordinary times.").

166. See *supra* note 74 and accompanying text.

167. See Rogers & Wheatley, *supra* note 8, at 90.

168. See *id.* Two-way communication is an express part of Kotter's fourth stage of change leadership: communicating the change vision. See *supra* note 119 and accompanying text.

169. See Schapiro, *Lessons*, *supra* note 101.

that Director Khuzami and employees of the Division of Enforcement engaged in discussion about ongoing strategies and directives to achieve change in the Division.<sup>170</sup> These examples of inclusive attitudes and actions show a capacity for the kind of intra-organizational engagement that comprises successful organizational change efforts.

3. *We Do Not See "Reality"; We Each Create Our Own Interpretation of What Is Real*

Just as individuals react to communications in individualized manners, different people interpret situations and events in different ways.<sup>171</sup> These unique and diverse perspectives pose challenges for change leaders that can only be met through communication between and among the group members about the divergent perceptions.<sup>172</sup> The desired result? The birth of "new ways of thinking" and eventual agreement on and support for a shared response.<sup>173</sup> The prognosis for success on the part of Chairman Schapiro and Director Khuzami in abiding by this principle is the same as that on the part of these SEC change leaders in abiding by the preceding principle,<sup>174</sup> because both principles are built on appreciating and learning from the rich diversity of responses to stimuli in organizational settings. In leading change at the SEC, Chairman Schapiro and Director Khuzami must remain sensitive to the differing perspectives of others within the agency and encourage a shared discourse and approach.

4. *To Create Better Health in a Living System, Connect It to More of Itself*

This final principle relates to searching for answers and solutions from within the organization, as the same may be broadly conceived.

This principle embodies a profound respect for systems. It says that they are capable of changing themselves, once they are provided with new and richer information. It says that they have a natural tendency to move toward better functioning or health. It assumes that the system already has within it most of the expertise that it needs. This principle also implies that the critical task for a leader is to increase the number, variety, and strength of connections within the system. Bringing in remote or ignored members, providing access across the system, and through those connections stimulating the creation of new information—all of these become primary tasks for fostering organizational change.<sup>175</sup>

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170. See *supra* note 119.

171. See Rogers & Wheatley, *supra* note 8, at 91.

172. See *id.* at 92.

173. See *id.*

174. See *supra* notes

175. Rogers & Wheatley, *supra* note 8, at 93.



The attitudes, skills, and experiences of Chairman Schapiro and Director Khuzami noted in describing the first three principles, all of which involve the engagement of group members in the ongoing process of organizational change, will serve them well in observing the fourth principle.<sup>176</sup> In some respects, this fourth principle may be best seen as a unifying one—effective change leaders can foster change within the organization because they will involve everyone in the organization in making change, and will engage everyone in the organization in communication about their individualized responses to the change message and their unique interpretations of situations and events. In other words, the effective change leader treats the organization as a living organism.

D. *In Developing a Strategy for Organizational Change, Success Is More Likely If Leaders Frame the Issues from a Number of Different Perspectives*

Finally, it is significant to note that successful change leaders use a “comprehensive ‘multi-frame’ approach”<sup>177</sup> in determining their strategies for organizational reform, rather than remaining “wedded to one or two ‘frames.’”<sup>178</sup> A leader who frames questions and answers narrowly is less likely to fully appreciate how his or her organization works and, therefore, is less likely to find success in organizational change efforts.

Leadership gurus Lee Bolman and Terry Deal recommend four frames that are critical to understanding, supporting, and embedding organizational change: the “human resources frame,” which “focuses on needs and skills”; the “structural frame,” centered on “alignment and clarity”; the “political frame,” which spotlights “conflict and arenas”; and the “symbolic frame,” focusing on “meaning and purpose.”<sup>179</sup> The political and symbolic frames are especially important—and often neglected or underemphasized.<sup>180</sup>

1. *The Human Resources Frame*

Leaders who frame the organizational change process from a human resources perspective understand that successful change relies on the development of new knowledge and skills within the organization through

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176. See *supra* notes 161-64, 169-70, 174, and accompanying text.

177. Bolman & Deal, *supra* note 8, at 7 (articulating four-frame approach to change initiatives).

178. *Id.*

179. *Id.* In summarizing the purpose, emphasis, and impact of the four frames, Professors Bolman and Deal note that:

[t]he road to change is never easy, no matter how good the intentions or far-reaching the support. However, if managers and change agents utilize a well-orchestrated, integrated design that responds to needs for learning, realignment, negotiation, and grieving, they just may find themselves in the fast lane toward success and improvement.

*Id.* at 11.

180. See *id.*

training.<sup>181</sup> Training not only prepares group members for change but also makes them more confident in pursuing and embracing change.<sup>182</sup>

Happily, the SEC is not ignoring the human resources frame. Staff training was an early initiative in Chairman Schapiro's change leadership efforts.<sup>183</sup> In fact, many of Chairman Schapiro's and Director Khuzami's public statements focus on this aspect of change at the SEC generally, and in the Division of Enforcement specifically.<sup>184</sup>

## 2. *The Structural Frame*

Organizational structure, as well as knowledge and skills, must support the organizational change effort.<sup>185</sup> To minimize "confusion, ambiguity, and distrust," "change efforts must anticipate structural issues and work to realign roles and relationships."<sup>186</sup>

The SEC also seems to have given attention to the structural frame, although additional structural changes may be required as the change vision continues to be implemented. Chairman Schapiro has emphasized the key role of restructuring in creating positive change.

I am confident that in a few years, we *will* be able to look back at an agency that helped to restore investor confidence, that restructured key divisions, that changed a formerly insular culture, that passed rules giving shareholders a better chance to vote for the directors of the companies they own, that enhanced the amount of information contained in proxies, that shed light on the dark spots within our markets, and that closed loopholes that contributed to the financial crisis.<sup>187</sup>

The Division of Enforcement has already gone through massive structural changes.<sup>188</sup>

## 3. *The Political Frame*

"Changing invariably creates conflict"—disputes with winners and losers.<sup>189</sup> Having observed that organizational group members have different responses to change messages and that no two people tend to interpret situations and events in precisely the same way, and that these

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181. *See id.* at 8.

182. *See id.* at 8-9.

183. *See supra* note 41 and accompanying text.

184. *See, e.g.,* Khuzami, AICPA Remarks, *supra* note 64; Khuzami, Enforcement Cooperation and New Senior Leaders, *supra* note 120; Schapiro, Embracing Change, *supra* note 64; Schapiro, Lessons, *supra* note 101.

185. *See* Bolman & Deal, *supra* note 8, at 9.

186. *Id.*

187. Schapiro, Lessons, *supra* note 101.

188. *See supra* notes 41, 129, 132, 141, and accompanying text.

189. *See* Bolman & Deal, *supra* note 8, at 9.

differences can be resolved through natural interactions,<sup>190</sup> we also can see how conflict borne of change can be resolved through give-and-take between and among organizational constituents. According to Bolman and Deal, the key is preventing the conflict from becoming a “street fight” and instead channeling it into an “arena”—a more organized, supervised forum.<sup>191</sup>

Unsurprisingly, there is not much public evidence of dissent from within the SEC to Chairman Schapiro’s organizational change efforts. Personnel reshufflings in the Division of Enforcement appear to have created the most conflict, according to media reports.<sup>192</sup> It is and will be important for Chairman Schapiro and Director Khuzami to react to the inevitable clashes that arise in their organizational change efforts by creating “processes of negotiation and bargaining where settlements and agreements can be hammered out.”<sup>193</sup>

#### 4. *The Symbolic Frame*

Finally, a change leader needs to pay attention to symbols as he or she carries forward his or her change vision. “The meaning of an object or event can be far more powerful than the reality.”<sup>194</sup> Symbols create emotional reactions in group members.<sup>195</sup> Accordingly, a change leader must be aware of symbols that are destroyed or otherwise impacted by his or her vision or strategies.<sup>196</sup> The organization, as a culture, must directly address these impacts through “transition rituals”—a process for helping group members “let go of the past, deal with the pain of the present, and move into a meaningful future.”<sup>197</sup>

Certainly, by engaging in its reform efforts, the SEC is impacting and will continue to impact symbols, both negative and positive. For example, Bernard Madoff has become a symbol of the SEC’s incompetence that both Chairman Schapiro and Director Khuzami are working hard to destroy.<sup>198</sup> And by changing the nature of leadership positions in the Division of Enforcement,<sup>199</sup> the SEC may be destroying symbols associated with that former leadership structure. Change leaders at the SEC must be sensitive to the collateral effects of their vision and strategies on symbols,

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190. *See supra* Parts II.C.2. & 3.

191. *See Bolman & Deal, supra* note 8, at 9.

192. *See supra* note 77.

193. Bolman & Deal, *supra* note 8, at 9.

194. *Id.* at 10.

195. *See id.*

196. *See id.*

197. *Id.* at 11.

198. *See, e.g., Madoff Failure Testimony, supra* note 41; Schapiro, Lessons, *supra* note 101.

199. *See Khuzami, Enforcement Cooperation and New Senior Leaders, supra* note 120.

and employ appropriate transition rituals to prevent disruptions and distractions associated with the impact of change on those symbols.

### III. CONCLUSION

Organizational change requires thoughtful, informed planning and execution. Organizations that succeed in achieving lasting change have certain common characteristics in their change leadership, as evidenced in change leadership literature. Leaders of successful organizational change efforts are “wartime leaders” and “problem-finders.”<sup>200</sup> They understand and effectively employ recognized stages of successful organizational change.<sup>201</sup> In doing so, they treat the organization as a living creature<sup>202</sup> and explore and apply change visions and strategies using a multi-frame analysis.<sup>203</sup> Each of these aspects of successful organizational change is evidenced in change leadership literature.

While at first blush the SEC may appear to be ill-equipped to engage in successful organizational change (given recent regulatory failures and inadequate and inefficient regulatory responses), Chairman Schapiro and Director Khuzami, as two key SEC leaders, exhibit attributes of successful change leaders and have begun to follow a path of organizational change that shows promise for success. That may be conscious; they may be fully aware of the change leadership literature summarized in this Article. In that case, this Article merely highlights to others the literature that already guides their calculated actions. On the other hand, the engagement of Chairman Schapiro and Director Khuzami with the characteristics and processes of successful change leadership may be accidental or incidental. In that event, this Article may be able to better inform and direct their collective efforts (and those of other change leaders at the SEC) toward further and more lasting successful organizational change.

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200. *See supra* Part II.A.

201. *See supra* Part II.B.

202. *See supra* Part II.C.

203. *See supra* Part II.D.

